

## **TITLE 18. BOARD OF EQUALIZATION**

### **NOTICE OF DECISION REQUIRED BY GOVERNMENT CODE SECTION 11340.7**

On Monday, February 23, 2015, the State Board of Equalization (Board) received a petition dated February 18, 2015, from Ms. Jenny Lee (petitioner), pursuant to Government Code section 11340.6, requesting that the Board repeal California Code of Regulations, title 18, section (Regulation or Reg.) 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices*, or, alternatively, that the Board repeal subdivisions (a)(3) and (4), (b)(3) through (6), and (c) of Regulation 1585. The petition requested that the Board repeal the regulation or the portions of the regulation clarifying the measure of tax with regard to sales of wireless telecommunications devices in “bundled” transactions because petitioner asserted that the regulation is inconsistent with the statutory definition of “gross receipts” in Revenue and Taxation Code (RTC) section 6012.

RTC section 7051 authorizes the Board to prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of the Sales and Use Tax Law (RTC, § 6001 et seq.), and the Board adopted Regulation 1585 pursuant to that authority.

The Board’s Legal Department reviewed the petition and prepared a Chief Counsel Memorandum dated March 12, 2015, which recommended that the Board deny the petition in its entirety because Regulation 1585’s provisions clarifying the measure of tax with regard to sales of wireless telecommunications devices in bundled transactions are consistent with the definition of “gross receipts” in RTC section 6012 and judicial precedent interpreting that definition. The memorandum explained that:

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer’s gross receipts from the retail sale of tangible personal property in California. (RTC, § 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Reg. 1700, subd. (a)(1).) If a retailer collects sales tax reimbursement that is computed on an amount that is not taxable or on an amount in excess of the taxable amount, the retailer is required to return the excess amount paid to the customer. (RTC, § 6901.5; Reg. 1700, subd. (b).)

When sales tax does not apply, use tax is imposed, measured by the sales price of property purchased from a retailer for storage, use, or other consumption in California. (RTC, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (RTC, § 6202.) Every retailer “engaged in business” in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, § 6203; Reg. 1684.) However, a consumer remains liable for reporting and paying use tax to the Board when the use tax is not paid to a retailer that is registered to collect the tax. (Reg.

1685, subd. (a).) In addition, RTC section 6901 expressly provides for the Board to refund overpaid use tax to a consumer that reported and paid the use tax to the Board, and for the Board to refund directly to a consumer “[a]ny overpayment of the use tax by [the consumer] to a retailer who is required to collect the tax and who gives the purchaser a receipt therefor.” (RTC, § 6901; Reg. 1685, subd. (a).)

RTC sections 6011 and 6012 similarly define the terms “sales price” and “gross receipts” so that the measure of tax is substantially the same with respect to sales and use tax transactions. In relevant part, RTC section 6012, subdivisions (a)(1) and (2), and (b)(1) through (3), expressly provide that:

- (a) “Gross receipts” mean the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers, valued in money, whether received in money or otherwise, without any deduction on account of . . . (1) The cost of the property sold. . . [or] (2) The cost of the materials used, labor or service cost, interest paid, losses, or any other expense.
- (b) The total amount of the sale or lease or rental price includes all of the following:
  - (1) Any services that are a part of the sale.
  - (2) All receipts, cash, credits and property of any kind.
  - (3) Any amount for which credit is allowed by the seller to the purchaser.

As relevant here, the Board’s long-standing interpretation of RTC section 6012 is that “[s]ervices that are a part of the sale’ include any the seller must perform in order to produce and sell the property, or for which the purchaser must pay as a condition of the purchase and/or functional use of the property, even where such services might not appear to directly relate to production or sale costs.” (See, e.g., Sales and Use Tax Annotation [footnote omitted] 295.1690 (8/16/78).) Also, the California court’s and the Board’s long-standing interpretations of RTC section 6012 are that a retailer’s gross receipts include all of the retailer’s receipts from the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer. (See, e.g., *Anders v. State Board of Equalization* (1947) 82 Cal.App.2d 88 [gross receipts included non-mandatory tips paid to retailer’s waitresses for serving food to the extent waitresses agreed to credit the tips against retailer’s obligation to pay minimum wage]; Sales and Use Tax Annotation 295.0430 (5/9/73) [amount received from a manufacturer as reimbursement for accepting the manufacturer’s coupon from the customer is included in gross receipts].) In addition, retailers may collect sales tax reimbursement from their customers on the full amount of their gross receipts from the sale of tangible personal property, including amounts received from third parties, if their contracts of sale so provide. (Sales and Use Tax Annotation 295.1045 (3/11/93).)

¶ . . . ¶

It is a common practice in the wireless telecommunication industry for a retailer to offer to sell a wireless telecommunication device for a fair retail price (cost plus a mark-up) and for the retailer to offer to sell the same device for a discounted price if the sale of the device is coupled (or bundled) with the purchase of wireless telecommunication service because the wireless service provider will indirectly reimburse the retailer for giving the consumer a discount on the device, similar to the manner in which a manufacturer may reimburse a retailer for accepting the manufacturer's coupon. However, this practice first started to become prevalent after the California Public Utilities Commission reversed the long-standing ban against "bundling" in 1995. Board staff worked closely with retailers of wireless telecommunication devices and wireless telecommunications service providers to provide clear and administratively efficient guidance regarding the application of the Sales and Use Tax Law to sales of wireless telecommunications devices in bundled transactions when the practice was new. Thus, the provisions ultimately included in Regulation 1585, which the Board adopted on October 15, 1998, are the result of a collaborative effort between retailers of wireless telecommunication devices, wireless telecommunications service providers, and the Board.

¶ . . . ¶

As relevant here, the current provisions of subdivision (a)(4) of Regulation 1585 define the unbundled sales price of a wireless telecommunication device as the actual "price at which the retailer has sold [such] specific wireless telecommunication devices to customers who are not required to activate or contract for utility service with the retailer or with an independent wireless telecommunications service provider for utility service as a condition of that sale." The current provisions of subdivision (a)(3) of Regulation 1585 clarify for retailers that a bundled transaction is an agreement for the sale of a wireless telecommunication device that "contractually requires the retailer's customer to activate or contract with a wireless telecommunications service provider for utility service for a period greater than one month as a condition of that sale." The current provisions of subdivision (b)(3) of Regulation 1585 also clarify for retailers that, in bundled transactions where the customers are paying the retailers a discounted sales price for a wireless telecommunication device and wireless telecommunications service providers are paying the retailers rebates or commissions for selling the devices at discounted prices with the required services, the retailers' gross receipts from the sale of the devices are limited to the unbundled sales prices of the devices as determined from actual sales, and do not include any amounts in excess of the unbundled sales prices. In addition, the current provisions of subdivision (a)(4) of Regulation 1585 provide an objective and administratively efficient way of reporting tax for retailers who cannot establish the unbundled sales price of a wireless telecommunication device by looking at an actual unbundled sale of the device. Subdivision (a)(4) provides that these retailers shall report and pay tax on the fair retail selling price of the device, which is equal to the cost of the device plus a markup on cost of at least 18 percent.

The Board scheduled a hearing on the petition for March 26, 2015, and made the petition and the March 12, 2015, Chief Counsel Memorandum available to the public as an attachment to the Board's public agenda notice for its March 25 and 26, 2015, meeting.

Prior to the March meeting, the Board received a letter from Mr. Jai Sookprasert, Assistant Director of Governmental Relations for the California School Employees Association (CSEA), which is a member of the AFL-CIO. In the letter, Mr. Sookprasert stated that the CSEA and AFL-CIO join Board "staff's opposition to the petition." Mr. Sookprasert agrees with Board staff that Regulation 1585 "is consistent with case law holding that a retailer's gross receipts include all of the retailer's receipts from the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer." Mr. Sookprasert also expresses the CSEA's and AFL-CIO's opinion that Regulation 1585 "is important because it guides the state to not permit companies to escape paying taxes by artificially transforming a clearly taxable transaction (sale of a phone) to another, possibly more lucrative transaction (in this case, the extended phone contract), and then also to claim an exemption from taxes."

During the hearing on March 26, 2015, the Board considered the petition. The Board heard comments from Mr. Ed Howard, from the California Tax Reform Association (CTRA), who said that the CTRA opposes the petition. The Board heard comments from Mr. Daniel Hattis, petitioner's attorney, in support of the petition and the petitioner's request that the Board repeal Regulation 1585. The Board also heard comments from Board staff, which explained why the Board's Legal Department concluded that Regulation 1585 is consistent with RTC section 6012. At the conclusion of the hearing, the Board Members unanimously voted to deny the petition because the Board agreed that that Regulation 1585 is consistent with RTC section 6012 for the reasons set forth in the March 12, 2015, Chief Counsel Memorandum.

Interested persons have the right to obtain a copy of the petition from the Board and may do so by contacting Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080. A copy of the petition is also available on the Board's website at [www.boe.ca.gov](http://www.boe.ca.gov).

Questions regarding this matter should be directed to Mr. Bradley Heller, Tax Counsel IV, by telephone at (916) 323-3091, by e-mail at [Bradley.Heller@boe.ca.gov](mailto:Bradley.Heller@boe.ca.gov), or by mail at State Board of Equalization, Attn: Bradley Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.